BEFORE THE TAX COMMISSION OF THE STATE OF IDAHO

In the Matter of the Protest of	)	
	)	DOCKET NO. 19592
[REDACTED]	)	
Taxpayer.	)	DECISION
	)	
	)	

On July 7, 2006, the staff of the Sales Tax Audit Bureau of the Idaho State Tax Commission (Commission) issued a Notice of Deficiency Determination [Redacted] (taxpayer) proposing sales and use tax and interest for the period of February 1, 2003, through January 31, 2006, in the total amount of $18,347.

On August 7, 2006, the taxpayer filed a timely appeal and petition for redetermination. On November 17, 2006, an informal hearing was held by teleconference.

[Redacted] An employee of that company was present in Idaho for approximately three weeks during the installation period.

Idaho Code § 63-3621 imposes a use tax on the storage, use, or other consumption of tangible personal property in this state. The use tax is a complementary tax to the sales tax. Every state that imposes a sales tax also imposes a use tax. The use tax rate is the same as the sales tax. A person who pays sales tax to his vendor when buying tangible personal property does not owe any use tax. Use tax is only due when the purchaser does not pay sales tax at the time of sale.

Idaho Code § 63-3612 states that "the term 'sale' means any transfer of title, exchange or barter, conditional or otherwise, of tangible personal property for a consideration…" Sales of real property improvements are not included within this definition and are, therefore, not subject

to sales or use tax. Sales and use taxes are imposed only on retail sales. Retail sales are sales to the ultimate consumer. Idaho Code § 63-3609 defines retailer as:

> **63-3609. RETAIL SALE -- SALE AT RETAIL. --** The terms "retail sale" or "sale at retail" means a sale for any purpose other than resale in the regular course of business or lease or rental of property in the regular course of business where such rental or lease is taxable under section 63-3612(h), Idaho Code.
>
> (a) All persons engaged in constructing, altering, repairing or improving real estate, are consumers of the material used by them; all sales to or use by such persons of tangible personal property are taxable whether or not such persons intend resale of the improved property.
>
> (b) For the purpose of this chapter, the sale or purchase of personal property incidental to the sale of real property or used mobile homes is deemed a sale of real property.

For this reason, contractors improving real property pay sales or use taxes on all their purchases of building materials that they install in real property. The taxpayer is arguing in this case that the store fixtures are improvements to realty. This would change the point at which tax is imposed. If the fixtures are real property improvements, then the sale of the installed fixtures to the taxpayer would not be a retail sale as defined by the Sales Tax Act and would not be taxable. In that case, the contractor would owe sales or use tax on its purchase of the materials used to make the fixtures. Thus, the sole issue is whether the fixtures retain the characteristics of personal property.

[Redacted] The issue of when an item becomes part of the real estate has been a thorny one for the Tax Commission. The issue usually arises in different contexts, however. Because real property improvements are not included within the production exemption, Idaho Code § 63-3622D, manufacturers benefit by classifying structures used in manufacturing or farming as personal property. The issue also arises in the case of contractors working on jobs for organizations exempt from sales tax, such as nonprofit schools and hospitals. This is because contractors improving real property can not claim the exemption of the exempt agency that hires

them. They owe use tax on purchases of materials they install in realty; however, retail sales of personal property to such an organization are exempt from sales tax.

This appears to be the first time that the imposition of sales or use tax on the purchase of store fixtures has arisen as an issue in a sales tax dispute. In the past, the Tax Commission has consistently treated such store fixtures as personal property.

The law of fixtures is complicated. As the Idaho Supreme Court has stated:

> The question as to when an article loses its character as personal property, and takes on the character of a Fixture so as to become a part of the realty, is one which has given rise to a multitude of decisions. The authorities are more or less conflicting. It seems that the question is of such an artificial character that no criteria or tests can be laid down which would be found to be of universal application. *Boise-Payette Lumber Co. v. McCornick*, 32 Idaho 462, 186 P. 252 (1920).

The Commission has adopted the common law three factor test to determine when personal property has become a permanent part of realty. Rule 067 (IDAPA 35.01.02.067) states that the three factors are annexation to the realty, either actual or constructive; adoption or appropriation to the use or purpose to which that part of the realty to which it is connected is suitable; and intention to make the article a permanent addition to the realty. The problem with this test is that it yields different results depending on the parties involved. For the purposes of the Sales Tax Act there must be some sort of consistent rule to apply. The Commission's decisions in this area must be made with the administration of the sales and use tax laws in mind. A review of decisions from other jurisdictions supports this position.

For instance, in *Zimpro, Inc. v. Commissioner of Revenue*, 339 N.W.2d 736 (1983), the Minnesota Supreme Court held that the equipment used in a wastewater treatment plant was tangible personal property. The Court in *Zimpro* stated:

> *Finally, if we adopt appellant's argument, the sales tax statute and its interpretation would be transformed into an even more confusing quagmire.* Appellant's assertions would require merchants to understand the common law of fixtures in order to determine whether a taxable transaction occurred for purposes of the sales and use tax. *Zimpro* at 740. (Emphasis added.)

An important factor in this case was the confusion that would be caused by holding the equipment to be part of the real estate.

The taxpayer's store fixtures are admittedly annexed to the realty. In fact, there are very few store fixtures that are not. It is not clear, however, why these display cases would be more difficult to remove than similar display cases in stores at large shopping centers. The store fixtures were installed after the construction of the building was complete. The removal of the display cases would not materially damage the structure itself.

As for adaptation, there are several tax cases from other states that focus on whether the fixtures are of benefit to the business or of benefit to the building. In *Donahue v. District of Columbia*, 451 A.2d 85, (1982), the District of Columbia Court of Appeals noted several cases from Ohio that followed this reasoning:

Placing major focus on the intention of the owner at the time of attachment, while appropriate in a conveyance case, may be inappropriate in the tax context. The nature of fixtures and personalty must be defined "in situations where the relationships between the public differ, or where considerations of public policy point in different directions, *e.g.,* eminent domain, taxation, vendor-vendee, and mortgagor-mortgagee." *Masheter v. Boehm*, 37 Ohio St.2d 68, 72, 307 N.E.2d 533, 537 (1974)….

Focus on the nature of annexation and use is appropriate in determining what constitutes a fixture in regard to assessing taxes. The state of Ohio, in tax cases, has almost exclusively emphasized the adaptation to the use for which property was annexed, stating that "the basic rationale of the cases is to the effect that the primary distinction between a fixture (real property) and a chattel (personal property) is whether the property is devoted primarily to the business conducted on the premises or whether it is devoted primarily to the use of the land upon which the business is conducted." *Wheeling-Pittsburgh Steel Corp. v. Jefferson County Board of Revision*, 27 Ohio St.2d 45, 46, 271 N.E.2d 861, 862 (1971). *See Roseville Pottery v. Board of Revision of Muskingum County*, 149 Ohio St. 89, 77 N.E.2d 608 (1948); *Zangerle v. Standard Oil Co. of Ohio*, 144 Ohio St. 506, 60 N.E.2d 52 (1945). The Ohio cases were discussed in Holden, *Classification of Property as Real or Personal for Ohio Property Taxes: An Appraisal*, 11 Ohio St.L.J. 153 (1950), where it was noted that:

A careful study of these cases indicates that the court realized that for the purposes of taxation it was faced with a different problem than the determination of the rights of private parties in or to property. *In taxation matters, it was essential that there be enunciated a rule or principle which could be objectively applied to produce a uniform result with as little attention to collateral facts as possible.* If the intention of private parties were to be accepted as the principle test for taxation, it would obviously open the door to evasion and discriminatory treatment within the classes intended to be uniformly benefited.... [T]he classification of the property for taxation could not depend upon the intention of the taxpayer without introducing utter confusion into the tax structure and its administration.... [I]t becomes clear why the court placed emphasis upon the appropriation test, subordinating matters of affixation, ready removability or intention of the party making the affixation. [*Id.* at 163-64.] *Donahue v. District of Columbia*, at 87. (Emphasis added.)

Once again, the *Donahue* Court considered the administration of the tax laws to be an important factor in its decision. The taxpayer's store fixtures in the case at hand [Redacted] would be of no benefit to any other type of business. For this reason they are not adapted to the use of the real estate and remain personal property.

To further support this position, the Commission notes that fixtures installed by a tenant in a leased building generally remain the personal property of the tenant. Idaho Code § 55-308 states:

> **55-308. REMOVAL OF FIXTURES BY TENANT**. A tenant may remove from the demised premises, any time during the continuance of his term, anything affixed thereto for the purposes of trade, manufacture, ornament or domestic use, if the removal can be effected without injury to the premises, unless the thing has, by the manner in which it is affixed, become an integral part of the premises.

The taxpayer in this case is technically a tenant in the building in which it is located. [Redacted] It is a factor, however, since it would be possible for one creditor to have a security interest in the display cases, while a different creditor could claim a security interest in the building. In any event, the Commission believes it is unwise to distinguish between owners and tenants for the purposes of the Sales Tax Act.

Most business people are not lawyers and are not prepared to apply the law of fixtures to every possible fact situation. The Commission has consistently treated store fixtures as personal property. It would be impossible for both the sellers and buyers of such fixtures to understand how the tax applies unless there is consistent treatment of these items. The Commission therefore holds that, for the purpose of the Sales Tax Act, the taxpayer's store fixtures have retained the characteristics of personal property.

Having determined that the store fixtures are not adapted to use of the real estate, it is not

necessary to examine the taxpayer's intent.

WHEREFORE, the Notice of Deficiency Determination dated July 7, 2006, is APPROVED, AFFIRMED, and MADE FINAL.

IT IS ORDERED and THIS DOES ORDER that the taxpayer pay the following tax and interest:

TAX	INTEREST	TOTAL
$18,314	$747	$19,061

Interest is calculated through January 31, 2007, and will continue to accrue at the rate set forth in Idaho Code section 63-3045(6) until paid.

DEMAND for immediate payment of the foregoing amount is hereby made and given.

An explanation of the taxpayer's right to appeal this decision is included with this decision.

DATED this _____ day of _____, 2007.

IDAHO STATE TAX COMMISSION

_____
COMMISSIONER

CERTIFICATE OF SERVICE

I hereby certify that on this _____ day of _____, 2007, a copy of the within and foregoing DECISION was served by sending the same by United States mail, postage prepaid, in an envelope addressed to:

[REDACTED] Receipt No.

_____